Institutional Operating Measures

Proceedings from the
National Postsecondary Education Cooperative/
National Association of College and University
Business Officers Forum

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PROCEEDINGS
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INSTITUTIONAL OPERATING MEASURES

September 13-14, 2000

On September 13-14, 2000, the National Postsecondary Education Cooperative (NPEC) and the National Association of College and University Business Officers (NACUBO) sponsored a forum on institutional operating measures. The forum convened interested and knowledgeable parties to examine the differences in the reporting standards utilized by various groups, including bond rating agencies and accounting firms. These differences result in incompatible operating measures for postsecondary institutions. The forum agenda is included in Appendix A; Appendix B is a list of participants. Background information on statements from the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB) for operating revenues, expenses, and measures were provided to participants. A summary of the discussion follows.

Keynote Address: Why Are Operating Measures Important?
Norwood "Woody" Jackson, Senior Director, KPMG

Jackson began his address by reviewing the manner in which postsecondary standard setters, including the FASB, the GASB, the American Institute of Certified Public Accountants (AICPA), and ratings agencies address both financial and nonfinancial information.

He observed that perspectives on operating measures frequently come from financial statements. Questions that should be addressed about annual reporting include, is the information produced in financial statements useful? What information is important? Does financial reporting meet the fundamental requirements of established standards? Is an unqualified statement important? What are the objectives of financial reporting? Is the report attractive or appealing? What is the nature of auditor's opinion?

Jackson said that colleges should consider making financial statements more inclusive by going beyond information about financial resources to include broader information that can be used to assess institutional performance and to make priority decisions. He also suggested that participants review FASB Concept Statement 4, focusing on the overall objectives of reporting information.

Colleges and universities should focus on the utility of information, i.e., who uses the information? What information do users need? The objectives of reporting including providing useful information for:

- Making resource allocation decisions;

- Assessing services and the ability to provide services in the future (internal strength of the college or university); and

- Assessing management stewardship and performance and providing information about economic resources.

Jackson emphasized the importance of dialog on assessing and reporting service efforts and accomplishments. What were the inputs and what were the results, both outputs and outcomes? He also observed that it is easy to measure the cost of an output, but not as easy to measure the cost of an outcome. He encouraged experimentation in the measurement of the cost of outcomes. A difficulty with assessing services is that efforts are often not measurable for many years. Postsecondary education should focus its efforts on measuring the effectiveness of programs on a longitudinal basis. He observed that FASB has stated that longitudinal information is the most useful information.

Jackson urged participants to focus on the institution's mission, goals, and objectives, develop measures of whether those objectives have been met, and present an analysis of the measures in financial reports. He observed that in the business arena, nonfinancial performance information may be the most important information, although it is usually not in the annual report. Fiscal health and academic performance are complementary. Jackson said that arguments may be made that academic performance information should not be reported in annual financial reports because it doesn't fit into accounting standards or models, and because the information is difficult to validate. Jackson argued that although measuring academic performance is a fledgling and difficult area, colleges and universities can and should provide this information. Work is needed to establish criteria to assure that the information is validated both internally and externally.

Jackson also encouraged colleges and universities to move away from timesheets and prescribed requirements that do not add to outcomes. He urged participants to care less about what a university spends money on and to "worry about results," to move away from micromanagement and demonstrate performance. He asked the audience, "Can we move from a compliance-based reality to a performance-based reality?" Jackson encouraged participants to think about conveying information to external communities, to consider performance–based information that will be useful to users of annual reports. He concluded his keynote address by saying "We have nothing but service to sell."

Audience Questions

A question was raised about the purposes of financial statements and whether a financial report is the best place for institutional performance information. Jackson responded that the annual financial statement is a disciplinary tool. Colleges and universities need to define what is important and measure whether they are accomplishing their objectives. He encouraged participants to start experimenting in this area and consider whether this information should be part of the required GASB/FASB standards. He said that there is a basis for the standard setters to experiment and move out of their traditional charge by using other forms of measuring performance, especially nonfinancial performance, and by having general criteria for performance common among various types of institutions or industries.

A second question was "How can we address performance measures if it takes a long time to see results?" Jackson suggested that postsecondary education begin with small steps and address long-term results, rather than ignore them because they are difficult to measure or because the longitudinal approach goes against the postsecondary education institutional culture.

Another question was asked about the precision and verifiability of measurements. Jackson said that it is difficult to deal with materiality and precision and suggested establishing reasonableness. Ask if the underlying data are of a nature that allows one to accept a measure. What data would make an informed person believe the accuracy of the information provided? What level of precision is necessary to inform a reasonable person and convince him or her to come to a different decision?

Panel Discussion of Keynote Address

Facilitator: Larry Goldstein, Senior Vice President and Treasurer, NACUBO

Panelists: Joseph Blythe, Project Manager, GASB
Ronald Bossio, Senior Project Manager, FASB
John Kroll, Associate Comptroller, University of Chicago

Larry Goldstein began the session by asking the audience about their interests. The audience raised a number of items, including consistency between FASB/GASB, performance-based funding and criteria, "free-for-all" operating measures open to individual judgment, accreditation process improvements, comparing measures of financial health for both publics and privates and within sectors, overall comparability among institutions, ways to help policymakers understand financial and performance issues, ways to develop informed financial decisions, and ways to have consistent, but flexible operating statements.

Blythe begin by noting that the GASB and FASB web sites (www.gasb.org or www.fasb.org) direct consumers and other interested parties to information about service efforts and accomplishments. He talked about Concept Statement #2, *Service Efforts and Accomplishments for Higher Education*, which GASB has been working on for the past 3 years. The concept statement sets standards for supplementary information on performance measurement. He also said that GASB is investigating the authority to set standards (see www.gasb.org for updates). Is GASB authorized to dictate service efforts and accomplishments and performance measures? Or, will GASB provide standards or suggestions for supplemental reporting? Blythe observed that 39 states are involved in some kind of performance measure budgeting or reporting.

Blythe gave an overview of the presentation and status of the GASB reporting that allows institutions to report for business-type activity as:

- Special purpose organizations engaged in governmental activities only,
- Special purpose organizations engaged in business type activities only, or
- Special purpose organizations engaged in governmental and business activities.

Most institutions will be reporting in the business activities or government and business activities categories. While not the same as the FASB standard, this approach brings public institutions closer to private institutions' standards. Blythe also observed that included in business-type activities are operating and nonoperating categories. State appropriations are nonoperating, which means that almost all public institutions will report a net operating deficit. Each entity is given some flexibility to determine definitions of operating/nonoperating.

Bossio began by stating that financial reporting is much broader than financial statements. He observed that organizations external to postsecondary education rank and evaluate colleges and universities, and that if postsecondary education doesn't provide performance measures, others will. He encouraged participants to focus on what is valued and useful to institutions. Bossio noted that financial statements provide information on economic resources, changes in financial resources, cash flows, and the results of operations (although interpreted in different ways, with FASB's focus on the entity as a whole). He said that financial statements are helpful in evaluating fiscal health. He identified a number of questions that should be asked about financial statements. Do users need one number, a magical answer, or trend analysis? What provides the operating results of the entity? Bossio observed that FASB 117 gave flexibility to the industry on what to include and not include; however, institutional reports should be fair presentations of activities. Different entities and users look at information in different ways. Bossio said that FASB doesn't have all the answers, and that line items should be descriptive to provide useful and reasonably homogenous information that allow users the ability to rearrange information to develop the measures that they need. FASB does not prescribe consistent operating measures.

Kroll discussed the perspective of AICPA in taking no position on the concept of operating measures. He observed that AICPA did not want to be in conflict with FASB. He noted that FASB 117 leaves defining operating measures up to postsecondary education entities. GASB states that operating measures should be defined as appropriate to the nature of the postsecondary education entity, and that operating measures should be used consistently from period to period. He said that broad guidance and latitude are provided by FASB and GASB, and that postsecondary education should take full advantage of this opportunity to bring the two standards together as close as possible with a single, uniform operating measure for all of higher education. The result would be more effective financial reporting.

Audience Discussion

Following the panel presentation, participants discussed the issue of investments (performance of investment portfolio) and the need to include strategies used to manage the organization in financial reporting. The difficulty of obtaining support for an operating measure from the entire postsecondary education industry was also discussed. One participant noted that higher education should keep in mind other users of financial information.

Goldstein observed that a goal to be considered by postsecondary education is a single, fundamental standard for an operating measure for all of postsecondary education. While it may be impossible to achieve, developing a statement that all entities can refer to regarding this issue could be helpful.

Current Operating Models Explained

Facilitator: Mark Putnam, Director, Office of University Planning and Research, Northeastern University

Mary Peloquin-Dodd, Director, Standard and Poor's
Phillip Tahey, Partner, KPMG
John Nelson, Manager, Moody's Investor Service
Jack McCarthy, Partner, PricewaterhouseCoopers

Peloquin-Dodd observed that Standard and Poor's, as a user of financial statements, has an interest in what is developed and is flexible and will work with whatever is developed. Standard and Poor's analyzes whether the institution is a stable business enterprise by evaluating ratios on a trend basis as a general guide as to how the institution is performing. Credit ratings measure an institution's ability to meet debt payments and are also a measure of fiscal health. While year-to-year operating information is an important measure, it's not the only one. Annual operating performance is more important to some institutions than others; a strong balance sheet can support an institution for a period of time despite income and expense fluctuations.

Peloquin-Dodd identified two challenges in developing an operating measure from Standard and Poor's perspective. First, no other industry has such radically different accounting models as postsecondary education, with some institutions that follow FASB standards and others that follow GASB standards. Second, Standard and Poor's has a goal of transparent information and doesn't like to rely on background information, unrestricted funds only, or unaudited information. Standard and Poor's places a priority on analyzing the whole institution's health. Bringing some consistency to reporting standards is supported, especially as the public becomes more involved in looking at financial statements. She said that bringing more comparability and consistency to the industry was highly desirable.

Tahey reviewed the KPMG composite financial index, which uses four ratios to derive an overall score of institutional financial health. The ratios are weighted toward accumulated wealth and must be linked to the institution's goals. He indicated that KPMG places a relatively low weight on net income ratio. Tahey said that boards of trustees tend to like simple ratios, while institutions do not. He indicated that the influencing factors for current models include peer group, size of institution, national/local audit firm and specific office of national firm, and state adoption of UMIFA. He said that a minority of institutions disclose fund groups; most institutions use a statement of activities by net asset class; some institutions use a separate statement of changes in unrestricted net assets; almost all Carnegie Research I have operating measures (fairly consistent among each other); most institutions disclose functional expenses in the statement of activities; a growing number of institutions are disclosing expenses by object in the statement; and about half of small to medium institutions use an operating measure with more variability in operating measures reported. Tahey said that common features of operating measurement items "below the line" include investment return in excess of spending rate, loss on disposals of assets, loss on financing, nonoperating contributions, endowment, and plant. Less common features of items below the line are fundraising costs, all contributions, and investment income.

Tahey identified dilemmas of determining an operating measure, including investment return less than spending rate, allocating depreciation, plant gifts and release of restrictions, activity in TRNA and PRNA (temporary and permanently restricted net assets), and nonrecurring items. He summarized his presentation by saying that whatever is decided about operating measures, they must be consistent with other approaches, that all other industry groups have trouble with net income (e.g., real estate), and that another possible regulator for postsecondary education, in addition to FASB and GASB, is the Securities and Exchange Commission, which regulates for-profit institutions.

Nelson began by explaining the rationale for Moody's Investors Service Rating Methodology. When analyzing the credit quality of postsecondary education, Moody's examines several broad credit factors including market position, financial resources, operating performance, debt position, and strategy and management. Basic principles are: postsecondary education is a business that competes for customers and provides a product/service; the core business line is youth personal development, including dorms, recreational centers, athletics, research, instruction, and training. He emphasized that operational analysis is critical especially for non-well-endowed schools. Moody's analysis focuses on core revenue sources, including tuition, auxiliaries, research grants, gifts, and investments, and regards depreciation as an expense. Moody's has developed separate ratios for private and public colleges and universities. Moody's operating measures include annual and average operating margins and operating margin excluding gifts, debt service coverage, return on financial assets, return on net assets, and gifts and investment reliance. Moody's has also developed ratios for market demand, capital, and balance sheet. He noted greater competition within higher education from the not-for-profit sector and the for-profit sector, and emphasized that postsecondary education must be nimble in this increasingly competitive environment, particularly, institutions without substantial endowments.

Nelson identified three challenges in developing an operating measure: endowment spending rate, net assets released, and capital gifts. He emphasized that institutional reporting in these three areas affects operating measure reporting and comparability among institutions. He said that operating performance is a proxy for good management. Nelson emphasized that operating measures tend to show higher surpluses and margins for well-endowed institutions and lower margins for less-well-endowed institutions.

McCarthy began by observing that his experiences at PricewaterhouseCoopers parallel those of other panelists. PricewaterhouseCoopers' position mirrors GASB and FASB. He emphasized that if institutions have operating measures, they should describe what is and what is not included. It is important for campuses to follow consistent and understandable reporting and to follow practices that do not mislead. McCarthy gave examples of some institutions that were wealthy, and observed that for these institutions, displaying a measure of operations has little meaning. He stressed the importance of peer analysis and said that a central question is, "What does an institution look like when compared to peers?"

McCarthy said that operating measures are not the only message that institutions should communicate. He talked about the importance of analyzing the overall change in net assets with growth from long-term investing, philanthropy, and operations. For the wealthiest institutions, changes in net assets typically derive in order of importance — long-term investing, philanthropy, and operations. However, most postsecondary institutions are not wealthy, and the changes in net assets are the reverse in order of importance — operations, philanthropy, and long-term investments. While there is little emphasis on operating measures for those institutions that are well endowed, the positions of the standard-setters have resulted in many people focusing on operating measures. He said that a survey will be sent to independent institutions to obtain information about campus practices and to solicit opinions about whether there should be operating measures and what should be done regarding consistency in reporting among institutions.

In the discussion that followed the panel, one participant said that while it is relatively easy to define operating measures, it is extraordinarily difficult to have a universal definition that is supported by all institutions. It was also suggested that asking institutions to provide 8 to 10 items in a disclosure or supplemental report could be helpful. Another participant emphasized that how management defines an operating measure depends significantly on the institution's mission.

BREAKOUT SESSIONS

Facilitators:
***Mary Fischer,* Professor of Accounting, University of Texas at Tyler**
***John Kroll,* Associate Comptroller, University of Chicago**
***Kathleen McNeely,* Managing Director, Financial Services, Indiana University**

In each of the breakout sessions, participants focused on operating measures by discussing these questions: What information is known or needed? What opinions exist about the feasibility of an operating measure? What could be achieved with an operating measure? What are the problems and why won't it work? What are alternatives to operating measures?

Breakout Session - Mary Fischer, Facilitator

Information known or needed

The group discussion was summarized with these comments: consistent, transparent financial statements are in everyone's best interest; currently too many models exist; the information is available, it's a question of how the information is displayed.

Participants also identified users including consumers, the industry (institutions and groups within institutions, e.g., unions), rating agencies, federal agencies, and the media. It was emphasized that each category of users might have a different need or purpose, and that different needs require different kinds of precision. It was also observed that perhaps there are more indirect users than direct users.

Opinions about the feasibility of an operating measure

Participants expressed a number of opinions about operating measures: Are they necessary? Is the amount of effort expended worth the benefit? Is the problem of a magnitude to merit the effort? How can institutional resistance to change be addressed? Given different missions and different goals of institutions, one size does not fit all, so how can an operating measure be developed? No guidance exists today, and the standard-setters will not tackle it. Institutions already have enough regulation; why should postsecondary education impose more regulation on itself?

What could be achieved with an operating measure?

Participants saw a number of goals that could be achieved with an operating measure, including increased comparability and transparency of information among institutions based on a common rationale; a common dataset and uniform definitions within the industry and professional accreditation; providing policymakers with information they want, assisting in the development of best/successful practices for the industry; facilitating research by providing comparative information that could be used with confidence; minimizing confusion, simplifying reporting, and reducing costs for the data provider; giving the institution a performance tool which could improve management through better decisions; and placing institutions in a leadership role in developing consistent measures, rather than others imposing measures which may be biased. Participants said, with some exceptions, that components of an operating measure could be defined with reasonably comparable information among institutions.

What are the problems and why won't it work?

A number of problems were identified, including definitional and reporting issues (What is the way to report operating measures? How can the components of the operating measures be defined?); longitudinal and comparability issues (How does this change affect trend lines? Can a crosswalk between old and new be done? How can private and public institutions be compared with operating measures?); audience issues (Who uses financial statements? Does postsecondary education have enough information about who the users are and how they might use operating measures?); and support of institutions (Will campuses embrace consistent operating measures?). Participants emphasized that mandatory standards are not acceptable to institutions. Concerns were expressed that an operating measure could be misused, e.g., by federal agencies, or that there could be unintended consequences from an operating measure. Although an operating measure is important, it is not the only measure of importance. Participants emphasized that "one size" doesn't meet all the needs. Consistent measures may not reflect institutional differences, and the diversity in postsecondary education makes it almost impossible to have a consistent measure for operations.

The group also debated whether there should be a measure and what the characteristics of the measure might be. They questioned whether postsecondary education could further the state-of-the-art by having consistent operating measures. They discussed measures using a continuum: no measure to best practices to guidelines to standards. The participants expressed the view that guidance was better than a prescriptive approach. The importance of distinguishing between clearer operating measures as opposed to finding "the" or "an" operating measure was emphasized.

What are alternatives to operating measures?

Some participants suggested that the conversation on operating measures should take place in 3 years when institutions have adjusted to GASB implementation. It was suggested that the industry could approach an operating measure as a best practices area, including consistency in reporting; that NPEC and NACUBO design a study to collect current practices; that regardless of what is done; (1) Definitions should be in an audited financial statements (disclosures allow flexibility for users), and (2) Be clear about what is in operating and not operating (If these definitions are included in a note to the financial statement, it would allow users to make a good decision on what is in an operating measure). The group noted that other alternatives include using management discussion and analysis (MDA), the SEC model, or other models.

Another suggestion was to develop a common data set approach as an alternative to consistent measures. Guidelines on deriving operating measures could result in consistency. Participants emphasized that guidance is needed, not a standard. At a minimum, postsecondary education should define what nonoperating is, and this information should be disclosed in the audited financial statement. This information should be developed, discussed, and disseminated by NPEC, NACUBO, AICPA, and other interested organizations.

Breakout Session - John Kroll, Facilitator

Information known or needed

The group began by discussing verifiable facts and facts believed to be true. GASB made a distinction between operating and non-operating, and state appropriations is non-operating. A determination of what is classified as operating or nonoperating is based, to some extent, on individual institutional circumstances with some latitude on the institution’s definition. At the time it issued its statements, FASB did not define operating measures; however, FASB did not preclude operating measures, and if operating measures are used, they must be defined. In addition, all expenses should be reported in appropriate places. Moody’s defines operations for the industry and uses a uniform spending rate for investments. Standard & Poor’s distinguishes between operating and nonoperating, and allows the institution to define spending rate and operations. AICPA guidelines are the same as FASB's.

National accounting firms do not mandate practices that are not set by a standard setter. The firms look for a level of consistency; and don’t want to be “lone rangers.” While accounting firms believe that an operating measure is a fundamental issue, they are unlikely to take the first step in defining operating measures. From a risk perspective, they are interested in operations because it’s a good early indicator, or early warning, of institutional stress.

Institutions are interested in comparative information from colleges and universities that they view as peers. While there are a number of common reporting practices within a state or geographic region, laws vary between states on reporting and other matters, which affects determination of an operating measure and makes comparisons difficult.

While NACUBO does not prescribe practices, it is pressured to “put standards out.” A survey is in process to evaluate current campus practices among independent institutions. States are interested in operating measures because of their focus on performance. Governors and legislatures are looking for ways to evaluate financial health of institutions and systematic ways for evaluating masses of data. While states want financial health information, they are less interested in operational data. States also want consistent data and measures among institutions and states.

Accreditors are trying to address difficult issues, such as performance, and are under pressure to define institutional effectiveness. Operational data give financial health information, which leads to institutional effectiveness. Accreditors look at financial threshold information, but are in a difficult position with a conflicting dual role of being advocates for the institutions and also “policemen.”

A number of known issues and questions were identified concerning reporting of operating measures, and whether expenses and income are counted as operating or non-operating:

How does the institution handle large gifts and bequests?
How are capital gifts for construction handled — as nonoperating, temporarily restricted, amortized against depreciation?
How is endowment income reported — yield vs. payout?
How are realized and unrealized gains reported?
How are restricted gifts handled?
How are gains on sales of assets reported?
How are federal/state grants and contracts reported?
For net assets, are investments separated by gift source?
Is there consistency in reporting state appropriations?
How is investment income reported?
How are earnings on working capital reported?
How is annual gift giving reported in general?

Opinions about the feasibility of an operating measure

Some participants were skeptical about whether it is possible to be successful in defining an operating measure and in gaining acceptance from all institutions. One problem is “a” there may not be *a* single measure. Since an institution’s operating measure could easily fluctuate from plus to minus from year to year, reporting and communicating what a measure means could be difficult.

In an environment of rapidly changing institutional missions and visions, the nature of transactions is also changing. A conceptual framework is needed to help explain changes. Being able to understand what drives operations would be helpful. Anyone using a financial report should understand what’s there and be able to make an appropriate judgment and evaluation. By keeping the discussion focused on a conceptual framework, it is possible to be flexible over a wider range of institutions.

Boards want to know “how did we do this year?” There is an urge to normalize in a volatile world. Why was operating performance good? Was it under the institution’s control? Was performance good due to a bequest from a donor? Few institutions believe that they have good explanations for these questions.

Reporting operating measures now presents problems; numbers can be manipulated because there are no standards or definitions. Institutions want NACUBO or some other organization to address these issues.

Financial reporting needs to mirror how an institution runs itself. The wealth of an institution colors how one views what is operating. Many small colleges rely on gifts to finance operations, and it is difficult to evaluate the impact of gifts when developing an operating measure. There is a reputational risk tied to gifts; when gifts decline from one year to the next, institutions are faced with bad press. How can gifts be operating when they are tied to external factors? A major gift could serve to confuse rather than illuminate the status of operations. There's a lesson from dot.coms: pumping up revenue numbers make the stocks more attractive. An undue amount of attention on a single number, or an operating measure, leads to manipulation.

How can you describe operations for a public institution and not include state or local support? How words like "results of operations" are used is part of the problem. The term "operations" is used in different ways in different discussions. Colleges and universities should develop definitions for "operations" and identify the audiences that need information about operations. If the value of an operational measure is to serve as early warning to financial difficulties at a college or university, then this purpose needs to be in and drive the definition.

At the end of the discussion, the majority of the group indicated that there should be an operating measure; others were not sure or felt that it depended on the definition and audience.

What could be achieved with an operating measure?

Participants identified various benefits, including an early warning sign of institutional health; comparability among privates, among publics, and between privates and publics; credibility with the public and Boards; improved internal communications since trustees "know the language"; a surrogate for management effectiveness (in theory, should be stable or improving); creation of a common language that answers the question, "how did we do this year"; assistance in providing the public assurance of financial soundness; responsive to the Cost Commission's statement that higher education finances are "opaque"; and responsive to the opportunity given to postsecondary education by FASB, AICPA, and GASB to develop an operating measure. A participant observed that if health care can create an operating measure, postsecondary education should be able to also, and if postsecondary education doesn't do it, someone else will.

What are the problems and why won't it work?

Participants identified a number of problems, including corrupt data; differences in state UMIFA precluding comparability; the great diversity in higher education and the difficulty in gaining consensus; the market leaders who are very wealthy and extremely vigilant about their image would be concerned if common measures bring wealth to light;

the lack of an enforcement mechanism if postsecondary education develops a voluntary reporting system for an operating measure; the variability of laws among states affects determination of operating measures and makes comparability difficult; institutions', particularly wealthy ones, fear that unsophisticated users of financial statements will misunderstand statements (an example was given that private corporations use idle cash and that higher education institutions may have idle cash, which could be difficult to explain to constituents); an operating measure could lead to other measures that highlight the deficiencies of some institutions, particularly less wealthy institutions, and could affect their future, e.g., attracting students, which, in turn, creates a great risk; by placing more value on a new, single number, the number could inappropriately become the main focus while it may be more, less, or equally important than other ratios, and may be misunderstood by the public; it creates pressure to use current information to forecast future fiscal health; it is not clear to institutions if transparency is good or bad (there's a view that for many small colleges fighting for survival in a competitive environment that transparency could be harmful); it is not clear who would be responsible for calculating the operating measure, and there is potential for manipulation and a lack of reliability; it could be costly to develop alternative and multiple measures with substantial front-end processes costs.

What are alternatives to operating measures?

Two options were presented. First, take the list of operating/nonoperating issues and ask institutions to disclose them in the financial report (currently institutions disclose two items — capital gifts and treatment of and release of restricted gifts). In this alterative, institutions would be asked for similar disclosure on:

- Endowment payout
- Gains
- Large gifts/bequests
- Investment earnings

A second option would keep current flexibility, including maintaining the financial statements as they are, with additional information in a footnote or another form of restatement such as surveys (assumes that institutions will be forthcoming in reporting).
Determination of an operating measure would be made through information from either notes or solicitation of data.

Other suggestions included develop different terminology for operations to diffuse attention and tension; provide a common definition even if it is not on the financial statement – there is great advantage with everyone using the same language to talk about operating measures; consider multiple operating measures, including broad measures (change in net assets) and/or narrow measures (operating revenue over expenses), and other measures between the two; identify multiple/different measures for different constituents.

The costs of developing alternative/multiple measures are substantial and would require representation from multiple constituents and multiple meetings, likely spanning a 12- to 18-month period.

Breakout Session - Kathleen McNeely, Facilitator

Information known or needed

Participants indicated that some clarifications are needed with regard to "questionable reporting items," for example:

- Fund raising
- Depreciation expense
- Losses on sale of property is extraordinary
- Investment revenue is net of expenses
- Expenditures for approved absences is included
- Capital expenditures are not included

Also participants identified areas of concern regarding where operating vs. nonoperating items are placed:

- Grant income?
- General pledge revenues?
- Cash vs. full accrual?
- Depreciation expenses?
- Restricted gifts?

Participants identified a number of key aspects of an appropriate operating measure model including:

- Tuition and fees
- Auxiliary revenues
- Non-capital state appropriations
- Academic sales and services
- Contracts, grants and gifts (when received, unrestricted and available; when classified as restricted or temporarily restricted, need to separate operating and nonoperating when released)

- Endowment within spending policy (or, endowment actually spent?)
- Interest income

They also noted these qualifications:

- Earnings above spending policy are not included
- Capital revenues are not included
- Pledge revenues are a problem and probably need to be dealt with over multi-year timeframes

A difficulty discussed is whether to stringently focus on revenues *received* or to focus on revenues *used* in a given period of time. While there is a desire to not let "management decisions" affect what is classified as "operating revenue," there is also a desire to reflect judgments that remove aberrations from what is classified as operating revenue.

Opinions about the feasibility of an operating measure

Participants expressed a number of opinions, including a belief on the part of institutions that there is little utility in having an operating measure; a general fear of operating measures and an opposition on the part of private and public institutions to mandated reporting – since an operating measure cannot be required, most institutions won't accept it; a reluctance on the part of institutions to change; and a fear on the part of some institutions of appearing to be too wealthy.

What could be achieved with an operating measure?

Participants identified a number of reasons why postsecondary education is being pushed to move toward operating measures. One reason was to build credibility with the public and develop better ways to communicate with the public. When postsecondary education is asked about the status of the industry, institutions need to give a good answer, and need to continually strive to give a better answer. The answer should also reflect different levels (for postsecondary education as a whole and for different sectors and for individual institutions). Other reasons included being accountable to the public and elected officials; being responsive to the desire of trustees who are influenced by corporate thinking and want to know how institutions are doing; addressing the concern that if postsecondary education does not develop the measure(s), then somebody else will; and having useful information for management purposes. Participants noted the importance of context: from the state perspective, it is desirable for all institutions to present the same measures. From the institutional perspective, it is desirable to have measures that are useful for internal insights, and that also work to the institution's advantage. It was noted that the best use of operating measures is to serve institutional purposes.

What are the problems and why won't it work?

Participants identified a number of difficulties with having operating measures, including lack of consensus on key considerations that must be determined to develop operating measures, e.g, what is operating vs. nonoperating; comparability issues; concerns that institutions can manipulate the bottom line to obtain the answer that they want; inconsistencies across statements and between statements and other sources of information; too much emphasis on one measure; interpretation of what the measure means; difficulty with reconciling different perspectives about what the measure should be; the reality of institutions functioning in different use contexts (rating vs. accountability vs. management) and the difficulty in responding to these different contexts with the same measure(s); disagreement over "technical issues" (e.g., single year vs. multiple year; what's above and below the bottom line); the need to respond to questions at different levels (e.g., for higher education as a whole and for different sectors and for individual institutions); uncertainty about how the measure might be used and who is using it and why; and credibility (postsecondary education formulates measures, but differently, which creates a credibility problem).

What are alternatives to operating measures?

Participants indicated the following: accountability and credibility are the big issues; understanding and consistency are the main objectives; using common measures is a reasonable approach, but there should be others that are tailored to distinctive institutional needs; a model should avoid prescriptions that limit institutional flexibility; a model needs to make a distinction between how data are reported and how data are analyzed.

General Group Discussion (Identification of consensus issues)

Facilitators:
***Larry Goldstein,* Senior Vice President and Treasurer, NACUBO**
***Mark Putnam,* Director, Office of University Planning and Research, Northeastern University**

Larry Goldstein and Mark Putnam facilitated a discussion of areas of agreement for the three groups. Those areas included the following:

- No absolute standard should be developed for an operating measure.
- A high degree of resistance to standards exists (although NACUBO constantly gets requests for standards).
- Information is available about operating measures.
- Information could be misused (institutions perceive abuse and manipulation of data with institutions reporting differently).

- An operating measure is not a “bottom line.”
- There is value in having “an” not “the” operating measure.
- Expectations for reporting are increasing for postsecondary education.
- Whatever is done should involve a reasoned process with a coalition of organizations; (NACUBO and its current data gathering efforts must be included in the discussion).
- An operating measure could be applicable to all institutions.
- Most institutions are reporting reasonably consistently.
- Agreements have not yet been reached for definitions of what is an operating measure and how to aggregate data points.

Participants observed that there are a number of different use contexts: external and internal (better internal management decisions, informing boards, etc.). Publishing some guidance to help institutions with using some intermediary measure might be good for internal management.

These next steps were suggested:

Consider replicating the AICPA process of involving institutions and others in the postsecondary industry to formulate a position.

Use the current NACUBO survey activity and ask institutions to submit copies of financial statements, ask them what should be done concerning an operating measure, and whether they would like to participate in the process.

For NPEC, participants indicated support within NPEC for working collaboratively with NACUBO on a study or participating in a focus group to work on these issues. Other participants indicated that NPEC could make a contribution based on the broad range of perspectives represented in the organization, and NPEC could help in working through the importance of non-financial measures.

Appendix A

NPEC/NACUBO FORUM
September 13-14, 2000
Hyatt Arlington,
Arlington, Virginia

POSTSECONDARY INSTITUTIONS' FINANCIAL OPERATING MEASURES

AGENDA

September 13, 2000

8:30 – 9:00 am	**Continental Breakfast**
9:00 – 10:00 am	**Welcome** ***Cheryl D. Blanco,*** **Director, Policy & Information, Western Interstate Commission for Higher Education and 2000 NPEC Chair** **Introduction** **Larry Goldstein, Senior Vice President and Treasurer, NACUBO** **Keynote Address:** ***"Why are operating measures important?"*** ***Norwood "Woody" Jackson, Senior Director,*** **KPMG**
10:00 – 11:00 am	**Panel Discussion of Keynote Address** **Facilitator:** ***Larry Goldstein,*** **Senior Vice President and Treasurer, NACUBO~~,~~** ***Joseph Blythe,*** **Project Manager, GASB** ***Ronald Bossio, Senior Project Manager, FASB*** ***John Kroll, Associate Comptroller, University of Chicago***
11:00 – 11:30 am	**Break**

September 13, 2000	**Continued**

11:30 – 12:30 pm	**Current Operating Models Explained** **Facilitator:** ***Mark Putnam,*** **Director, Office of University Planning and Research, Northeastern University** ***Philip Tahey,*** **Partner, KPMG** ***Jack McCarthy,*** **Partner, PricewaterhouseCoopers** ***John Nelson,*** **Senior Vice President, Moody's Investor Service** ***Mary Peloquin-Dodd,*** **Director, Standard & Poor's**
12:30 – 2:00 pm	**Lunch**
2:00 – 3:00 pm	**Models Explained (continued)**
3:00 – 3:30 pm	**Break**
3:30 – 5:00 pm	**Breakout Sessions** **Facilitators:** ***Mary Fischer,*** **Professor of Accounting, University of Texas at Tyler** ***John Kroll,*** **Associate Comptroller, University of Chicago** ***Kathleen McNeely,*** **Managing Director, Financial Services, Indiana University** ➢ ***What are the advantages to having consistent measures?*** ➢ ***Is there a compelling case for consistent measures over competing models?*** ➢ ***What should a model accomplish?*** ➢ ***What are the key aspects of an appropriate model?***

September 14, 2000

8:00 – 8:30 am	**Continental Breakfast**
8:30 – 10:00 am	**Breakout Sessions (continued)**
10:00 – 10:30 am	**Break**

10:30 – 12:00 pm **Plenary Session: Results of Breakout Sessions**

Facilitator:
Larry Goldstein, **Senior Vice President and Treasurer, NACUBO**

12:00 – 1:00 pm **Lunch And Facilitated Discussion On Next Steps**

Facilitators:
Larry Goldstein, **Senior Vice President and Treasurer, NACUBO**
Mark Putnam, **Director, Office of University Planning and Research*, Northeastern* University**

Meeting Adjourns

Appendix B

NPEC/NACUBO Forum
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